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AUG 7 2001

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Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Corsiglia
Joseph Horwedel

SUBJECT: SEE BELOW

DATE: August 2, 2001

Approved

Date

8.7.01 "

INFORMATION

**SUBJECT: RESPONSE TO MAYOR'S HOUSING PRODUCTION TEAM
RECOMMENDATIONS REGARDING INCLUSIONARY ZONING
(HOUSING PRODUCTION TEAM RECOMMENDATIONS #20 & #21)**

BACKGROUND

On January 21, 2001, the City Council accepted the report of the Mayor's Housing Production Team (HPT) and referred the recommendations in that report to the City Administration for responses. Two of the recommendations in the report were:

- "Implementation of an inclusionary zoning policy for affordable housing on all new rental projects in the city and study the impact of adoption of an inclusionary zoning ordinance in other cities." (HPT Recommendation #20) In its acceptance of this recommendation, the City Council expanded the scope of the study to include ownership as well as rental housing.
- "In the Specific Plan process for Central Coyote, affordable housing needs must be addressed. This could include inclusionary zoning, increased densities, increased public funding, private funding, etc." (HPT Recommendation #21)

On June 26, 2001, the City Council approved a series of recommendations with respect to affordable housing. Two of those recommendations were related to inclusionary zoning: (1) direction to the Central Coyote Specific Plan Task Force that 20 percent of all units developed in the Central Coyote Valley be deed restricted at below-market rate; and (2) direction to staff to continue to study the feasibility of a Citywide inclusionary zoning ordinance.

The Departments of Housing and Planning, Building and Code Enforcement have prepared this memorandum to provide the City Council with background information about this subject and to identify next steps. This memorandum provides: a definition of inclusionary zoning; results

from a previous inclusionary zoning study completed in the mid-1990s; and advantages and disadvantages of inclusionary zoning.

ANALYSIS

What Is Inclusionary Zoning?

Inclusionary zoning is a requirement, usually contained in a locality's zoning code, that a portion of the units in each development be made affordable by the developer without public funding. Of the inclusionary programs currently in existence in the Bay Area and Southern California:

- A majority require 10-15 percent of new residential units to be affordable.
- Minimum project size is typically 10 units (smaller projects are exempt).
- Most do not require that the affordable and market-rate units be identical, just similar in outward appearance.
- Most require that the affordable units be spread throughout the development.
- Most permit the developer to pay a fee in lieu of construction so that the otherwise-required number of affordable units can be built elsewhere.
- Nearly all programs provide for both low-income and moderate-income units, and about half require very low-income units.
- Most require restrictions on price to remain in effect for 30 years.

Some local governments do not require developers to build affordable units, but they offer builders the option of receiving one or more concessions in exchange for setting aside affordable units on their own volition. These incentives include reduced or deferred developer fees, density bonuses, reduced traffic/parking provisions, and reduced standards for setbacks and various other requirements. In cases that include for-sale housing in the restriction, units provided under voluntary inclusionary programs must also be placed under resale restrictions.

Previous Inclusionary Zoning Study

Inclusionary zoning has been raised as a possible solution to San Jose's affordable housing needs for many years. In 1989, the Mayor's Task Force on Housing recommended that inclusionary zoning be studied as a potential mechanism for increasing the affordable housing supply in San José. In response to the recommendation, the City Council appointed a task force to study the issue. The task force recommended that the City Council direct the Housing Department to contract with outside consultants for an analysis of the economic impacts of an inclusionary zoning program.

This report was completed by David Paul Rosen & Associates in September 1994, and presented to the City Council in January 1995 along with an analysis by the Housing Department. According to the consultant, as many as 8,000 units of affordable housing could have theoretically been built in San José by 2010 using an inclusionary zoning program. Based on results of the consultant's study, the Housing Department prepared an analysis based on its own experience with affordable housing, and feedback from other departments and sources. The Department's analysis concluded that, during poor economic conditions existing at the time, financial subsidies above and beyond such land use incentives as reduced parking requirements and density bonuses would need to be available for inclusionary zoning to work in San José.

The broader conclusion of the prior study is that inclusionary zoning will always be more effective in a heated housing market than during a downturn in the housing market. Thus, it may have worked in the strong housing market experienced in the region in recent years, but may be an impediment to residential construction if there is an economic downturn.

Current Inclusionary Requirements in San José

Within redevelopment project areas adopted – or areas added to prior projects – after January 1, 1976, State law requires that 15% of all new (or substantially rehabilitated) housing units in a redevelopment project area be affordable, with 9% affordable to moderate- or lower-income households and 6% affordable to very low-income households.

By City Council and Redevelopment Agency Board policies, each developer is required to fulfill this mandate within his/her development without public subsidy. The policy accomplishes this goal by requiring 9% of the units developed in any particular project to be affordable to low- or moderate-income households and 6% affordable to very low-income households.

Although it would be legally possible to use the 20% Low- and Moderate-Income Housing Fund to subsidize the affordable units, the policy of the Council/Agency Board reflects a desire to maximize the number of affordable units developed through any and all means. San José's policy identifies guidelines stating the affordable units must be comparable with the market-rate units, both inside and out. The Council/Agency Board policy allows the developer to pay an in-lieu fee to the Housing Department so that replacement housing units can be developed elsewhere.

State law allows the inclusionary zoning requirement to be met by building the affordable units outside the redevelopment project area on a two-for-one replacement basis. Under the Council/Agency Board policy, the in-lieu fee is doubled if the replacement unit(s) will be located outside the redevelopment project area. The two-for-one option in the State law has a sunset date of January 1, 2002, though based on previous legislative history, it can be anticipated that the sunset date will be extended for an additional period of time.

To date, most of the development affected by the redevelopment inclusionary housing requirement has been in the Rincon de los Esteros (North San Jose) project area. The policy has worked well because the demand for housing in this largely industrial/R&D areas is enormous,

and developers have been able to readily absorb the cost of providing affordable units because of the premium rents/sales prices on the market-rate units.

Advantages and Disadvantages to Inclusionary Zoning

There are many arguments either in favor of or opposed to inclusionary zoning, not all of which may be applicable in San José. Some of these are noted below:

Arguments in Favor

- Affordable housing can be created without the need for any investment of public funds (subject to the condition of the housing market as noted above).
- Affordable units in mixed income housing developments are physically indistinguishable from market-rate housing, thus avoiding the stigma sometimes attached to affordable housing.
- Inclusionary zoning fosters mixed socio-economic neighborhoods by integrating housing affordable to low/moderate-income households throughout the community.

Arguments Against

- In a depressed housing market, inclusionary zoning may discourage residential development.
- The cost of providing affordable units under an inclusionary zoning scheme is passed on to the buyers/renters of the market-rate units in the development, making market-rate housing more expensive.
- The administrative cost of implementing an inclusionary zoning ordinance is high, both to require developers to make some units affordable and to monitor the affordable units for the term of the price restrictions.

NEXT STEPS

There are a number of actions that the City and Redevelopment Agency are already pursuing in regards to inclusionary zoning:

1. The Housing Department and the Redevelopment Agency are in the process of evaluating the existing inclusionary housing policy in redevelopment project areas. This re-examination has been undertaken because of the prospective expansion of redevelopment into the Strong Neighborhoods Initiative areas. It is expected that recommendations to the City Council and Agency Board will be made in August 2001.

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2. In August 2001, the Planning Commission and City Council will be considering General Plan amendments associated with housing, including an amendment proposing that the Specific Plan for the Coyote Valley Urban Reserve include a requirement that 20 percent of all units be "deed-restricted, below-market-rate units."
3. The Housing Department's Fiscal Year 2001-02 Budget includes \$25,000 to retain a consultant to assist in an evaluation of the feasibility of a citywide inclusionary zoning requirement. The study will consist primarily of updating the 1995 study, and will be coordinated with other City departments through the Economic and Neighborhood Development (END) City Service Area (CSA) process. It is anticipated that the consultant's study will be completed by November 2001, though the process of securing review and comment by various stakeholders and community interests may not be concluded until a later date.

COORDINATION

Preparation of this report was coordinated with the Parks, Recreation and Neighborhood Services Department, the Redevelopment Agency, and the Offices of the City Attorney and the Redevelopment Agency General Counsel.



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